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No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

VERONICA ZUCKER, individually and on behalf of a class of others similarly situated,

Petitioner,

vs.

ALAN G. QUASHA; JACK E. ROSENFELD; RALPH DESTINO; J. DAVID HACKMAN, S. LEE KLING, THEODORE H. KRUTT SCHNITT, JEFFREY LAIKIND, ELIZABETH VALK LONG, EDMUND R. MANWELL, GERALDINE STUTZ, ROBERT F. RIGHT, WAYNE P. GARTEN, HANOVER DIRECT INC., SUN LIFE INSURANCE COMPANY OF AMERICA; MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., ALEX BROWN & SONS, INC., individually and on behalf of a class of underwriters similarly situated,

Respondents.

PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

Section 11 of the Securities Act of 1933 provides for the imposition of liability if "any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading. . ." 15 U.S.C. 77k(a) (Appendix C, A-20-A-25).

The information "required to be stated" in a registration statement is spelled out both in Schedule A to Section 7(a) of the Securities Act, 15 U.S.C. §§ 77g(a), 77aa and in various regulations promulgated by the Securities and Exchange Commission ("SEC") pursuant to its statutory authority.

Certain companies conduct public offerings pursuant to registration statements on SEC Form S-3. Item 11(a) of the instructions to Form S-3 requires that the issuer (registrant) describe in the portion of the registration statement comprising the prospectus:

> *any and all material changes in the registrant's affairs* which have occurred since the end of the latest fiscal year for which certified financial statements were included in the latest annual report to security holders and which have not been described in a report on Form 10-Q or Form 8-K filed under the Exchange Act.

Instructions to Form S-3, Item 11(a) (emphasis added) (Appendix D, A-26).

The question presented is may an issuer of securities, in a public offering pursuant to a registration statement on SEC Form S-3, disclose in the registration statement favorable historical information but omit mention of a dramatic reversal in financial performance which takes place during the fiscal quarter in which the registration statement becomes effective?

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OPINIONS BELOW

The opinion of the United States District Court granting defendants' motion to dismiss, is reported at 891 F. Supp. 1010 (D.N.J. 1995) (Appendix B, A-3-A-19). The Third

Circuit affirmed the decision of the District Court without opinion, 82 F.3d 408 (3d Cir. 1996) (table No. 95-5428) (Appendix A, A-1-A-2).

JURISDICTION

The judgment of the Court of Appeals was entered on March 26, 1996. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Section 11, 15 U.S.C. 77k(a) is reprinted as Appendix C, A-20-A-25. Item 11(a) of the instructions to Form S-3 is reprinted as Appendix D, A-26.

STATEMENT OF THE CASE

Veronica Zucker commenced this action on September 2, 1994 by filing the Complaint against Hanover Direct, Inc. ("HDI" or the "Company"), a direct specialty retailer which publishes a portfolio of branded specialty catalogs and sells merchandise, such as apparel and home furnishings, advertised in the catalogs.

The Complaint alleged that HDI violated the Securities Act of 1933 in connection with a $55,000,000 common stock offering which became effective on March 31, 1994 (the "Public Offering"). The Complaint charged, among other things, that the Registration Statement and Prospectus for the Public Offering were materially misleading with respect to an undisclosed increase in the rate of customer returns immediately prior to the Public Offering.

The Complaint named as defendants HDI; Merrill, Lynch, Pierce, Fenner & Smith, Inc. and Alex Brown & Sons, Inc., co-lead underwriters of the Public Offering (the "Underwriter Defendants"); 12 individuals who bore statutory responsibility for the content of the Registration Statement under Section 11(a)(1) and (2) of the Securities Act; and Sun Life Insurance Company of America, an entity which sold HDI stock to the public pursuant to the Public Offering. "HDI Defendants," as

used herein, refers to all defendants except the Underwriter Defendants.

No defendant answered the Complaint. On November 21, 1994, the HDI Defendants moved to dismiss the Complaint with prejudice for failure to state a claim upon which relief can be granted under Rule 12(b)(6), F. R. Civ. P. A memorandum of law and the declaration of their counsel, Stephen R. Lang, was submitted in support of the motion. Attached to the Lang Declaration were copies of the Complaint, the Prospectus part of the Registration Statement, HDI's quarterly report on Form 10-Q for the quarter ended April 2, 1994 and HDI's Form 10Q for the quarter ended July 2, 1994. The Underwriter Defendants also filed a motion to dismiss and relied upon the memorandum of law and Lang Declaration submitted by the HDI Defendants.

While the Complaint was denominated a proposed plaintiff class action on behalf of persons who acquired HDI stock pursuant to the Public Offering, and a defendant class action with the defendant class to consist of all underwriters of the Public Offering, no order for plaintiff or defendant class certification was sought or granted in the court below.

Oral argument on the motion to dismiss was held on May 22, 1995. By Judgment Order entered May 25, 1995, the District Court dismissed the Complaint with prejudice. The District Court issued an Opinion dated May 23, 1995. The District Court thereafter vacated the May 23 Opinion and issued a revised Opinion for publication dated July 6, 1995.

On March 26, 1996, the Third Circuit affirmed the judgment of the District Court entered on May 25, 1995.

REASONS FOR GRANTING THE WRIT

This Court should grant certiorari because this case presents an important question in which there is a direct conflict among the Circuits.

The First Circuit has held that if the issuer is in possession of non-public information indicating that the results of the

quarter in progress at the time the registration statement becomes effective constitutes an extreme departure from the range of results which could be anticipated based on currently available information, it is consistent with the basic statutory policies favoring disclosure to require inclusion of that information in the registration statement.

The Third Circuit has ruled that the issuer is not required to include this type of information in the registration statement.

Petitioner believes that the Third Circuit's ruling undermines the basic statutory policies favoring disclosure in registration statements filed under the Securities Act.

A. First Circuit

In *Shaw v. Digital Equipment Corp.*, 82 F.3d 1194 (1st Cir. 1996), purchasers of the securities of Digital Equipment Corp. ("Digital") asserted that there were non-disclosures in the registration statement and prospectus prepared in connection with a public offering of stock. The registration statement on SEC Form S-3 became effective on March 21, 1994, just 11 days prior to the close of the quarter then in progress, and about three weeks prior to the issuer's announcement of a negative earnings report for that quarter. Plaintiffs there claimed that the defendant issuer improperly failed to disclose pre-effective date material factual developments foreboding disastrous quarterly results.

The First Circuit concluded that the allegations relating to material omissions from the registration statement for the March 21, 1994 offering stated a legally cognizable basis for plaintiffs' claims, satisfying the pleading requirements of Fed. R. Civ. P. 9(b) and 12(b)(6). *Id.* at 1199. The First Circuit ruled that present, known information that strongly implies an important future outcome is not immune from mandatory disclosure merely because it does not foreordain any particular outcome. The question whether such present information must be disclosed poses a classic materiality issue: Given that at any point in a quarter, the remainder of the period may not mirror the quarter-to-date, is there a sufficient probability that

unexpectedly disastrous quarter-to-date performance will carry forward to the end of the quarter in which the registration statement becomes effective, such that a reasonable investor would likely consider the interim, most recent performance data important to the overall mix of information available? *Id.* at 1210. The First Circuit held that if the issuer is in possessior of non-public information indicating that the quarter in progress at the time of the public offering will be an extreme departure from the range of results which could be anticipated based on currently available information, it is consistent with the basic statutory policies favoring disclosure to require inclusion of that information in the registration statement. *Id.* One could not conclude, as a matter of law on a motion to dismiss, that such information was not subject to mandatory disclosure under the rubric of "material changes" in Item 11(a) of Form S-3. *Id.* at 1211.

B. Third Circuit

In *Zucker v. Quasha*, 891 F. Supp. 1010, (D.N.J. 1995), *aff'd*, 82 F.3d 408 (3d Cir. 1996) (table, No. 95-5428), the Plaintiff-Petitioner alleged that there existed an undisclosed, material adverse trend with respect to returns immediately prior to, and on, the effective date of the Public Offering and that the Registration Statement's statements on the subject of returns were materially false and misleading. On March 31, 1994, HDI's Registration Statement on Form S-3 for the offer and sale of HDI common stock became effective, one business day before the close of the Company's fiscal quarter which ended on April 2, 1994. The Plaintiff-Petitioner alleged that because the Prospectus/Registration Statement became effective less than three days before the close of the fiscal quarter, information regarding increased rate of returns must have been available to the issuer and that the issuer was obligated to disclose this trend in the Registration Statement.

HDI is a catalog company, deriving its revenues from merchandise sales solicited through the mailing of branded specialty catalogs to selected consumers. Under HDI's return policy, customers who purchased HDI merchandise could

return it for a refund, exchange or replacement if not satisfied. The Prospectus stated that the, "Company's return rate for 1993 was approximately 13% of gross shipments." The Prospectus portion of the Registration Statement informed Plaintiff-Petitioner and other purchasers on the Public Offering of the following:

> Results of Operations
>
> 1993 Compared with 1992
>
> * * * Revenues also improved as *the Company reduced its order cancellation and return rates compared to 1992*, principally as a result of improving its in-stock inventory position. (emphasis added).
>
> * * * 1992 Compared with 1991
>
> * * * Revenues were also improved *as the Company reduced its order cancellation and return rates by two percentage points compared to 1991.* (emphasis added).

HDI's fiscal year ended on January 1, 1994. The Registration Statement became effective March 31, 1994, one business day before the close of HDI's fiscal quarter. The reader of the Prospectus was told nothing about HDI's experience with customer returns during the almost three-month period immediately preceding the Public Offering.

On May 16, 1994, HDI filed with the SEC its Form 10-Q Report for the fiscal quarter ended April 2, 1994. There, for the first time, HDI publicly admitted that it had experienced an increase in the rate of returns from January 1 to April 2, 1994.

> Results of Operations
>
> *Thirteen Weeks Ended April 2, 1994 Compared With Thirteen Weeks Ended March 27, 1993.*
>
> Revenues were negatively impacted by an increase in customer returns to approximately 15% of

> shipped sales in the first quarter of 1994 from approximately 13% for the same period in 1993. The increased returns were generated by certain product categories and the Company is implementing measures to reduce the rate of returns of these items.[1]

The District Court adopted a "complete fiscal period" rule holding held that there was no duty to disclose information with respect to the rate of returns immediately prior to the Public Offering because HDI's first fiscal quarter would not be completed until two days after the Public Offering. The District Court further found that the Complaint failed to allege facts supporting a reasonable inference that the Registration Statement's statements concerning return rates were misleading. *Id.* at 1016. As indicated, the Third Circuit affirmed without opinion.

Respectfully, the District Court and the Third Circuit erred. Under Section 11(a) of the Securities Act, HDI's Registration Statement "spoke" as of March 31, 1994. On that date, there existed a material adverse trend with respect to returns, the omission which from the Registration Statement rendered the statements that were made on the subject of returns materially misleading. Such a material adverse trend was a required disclosure in the Registration Statement by virtue of Section 11(a) and Item 11(a) of the Instructions to Form S-3.

---

[1] The First Circuit, in *Shaw*, 82 F.3d at 1211, mischaracterized the holding in *Zucker* as dismissing the complaint based on alleged nondisclosure in a *March 31* registration statement of information relating to results of period ending *July 2*. In fact, in *Zucker*, the court dismissed the complaint based on nondisclosure in a March 31 registration statement of information for the fiscal period ending on April 2.

CONCLUSION

For the reasons stated above, and to eliminate the split between the Circuits, this Court should grant certiorari.

Dated: June 24, 1996
New York, New York

Respectfully submitted,

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APPENDIX

Appendix A

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

NO. 95-5425

VERONICA ZUCKER, individually and on behalf of a class of others similarly situated

v.

ALAN G. QUASHA; JACK E. ROSENFELD; RALPH DESTINO; J. DAVID HACKMAN; S. LEE KLING; THEODORE H. KRUTTSCHNITT; JEFFREY LAIKIND; ELIZABETH VALK LONG; EDMUND R. MANWELL; GERALDINE STUTZ; ROBERT F. WRIGHT: WAYNE P. GARTEN; HANOVER DIRECT, INC.; SUN LIFE INSURANCE COMPANY OF AMERICA; MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.; ALEX BROWN & SONS, INC., individually and on behalf of a class of underwriters similarly situated

VERONICA ZUCKER,
Appellant

On Appeal from the United States District Court
For the District of New Jersey
(D.C. Civil Action No. 94-cv-04301)
District Judge: Honorable William G. Bassler

Submitted Under Third Circuit LAR 34.1(a)
March 11, 1996

BEFORE: STAPLETON, SCIRICA, and COWEN,
Circuit Judges

JUDGMENT ORDER

After consideration of the contentions raised by appellant, it is

ORDERED AND ADJUDGED that the judgment of the district court entered May 25, 1995, be and the same is hereby affirmed.

Costs taxed against appellant.

By the Court,

/s/ Walter K. Stapleton

Circuit Judge

ATTEST:

/s/ P. Douglas Sisk

P. Douglas Sisk, Clerk

DATED: MAR 26 1996

Appendix B

FOR PUBLICATION

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

VERONICA ZUCKER, individually and on behalf of a class of others similarly situated,

Plaintiff,

v.

ALLAN G. QUASHA, JACK E. ROSENFELD, RALPH DESTINO, J, DAVID HACKMAN, S. LEE KLING, THEODORE H. KRUTTSCHNITT, JEFFREY LAIKIND, ELIZABETH VALK LONG, EDMUND R. MANWELL, GERALDINE STUTZ, ROBERT F. WRIGHT, WAYNE P. GARTEN, HANOVER DIRECT INC., SUN LIFE INSURANCE COMPANY OF AMERICA, and MERRIL, LYNCH, PIERCE, FENNER & SMITH, INC. and ALEX BROWN & SONS, INC., individually and on behalf of a class of underwriters similarly situated,

Defendants.

Civ. No. 94-4301
(WGB)

O P I N I O N

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FILED

JUL 7 - 1995

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BASSLER, DISTRICT JUDGE:

Defendants move to dismiss Plaintiff, Veronica Zucker's complaint pursuant to Federal Rule of Civil Procedure 12(b)(6) for failure to state a claim upon which relief can be granted. This Court possesses jurisdiction over this action under 28 U.S.C. § 1331.

For the reasons set forth in this Opinion, Defendants' motion is **granted.**

I. BACKGROUND

In deciding this motion to dismiss for failure to state a claim, the Court must accept all allegations made in the Complaint as true. *Markowitz v. Northeast Land Co.*, 906 F.2d 100, 103 (3d Cir. 1990). Plaintiff, Veronica Zucker, purchased 3,000 shares of common stock of Defendant, Hanover Direct, Inc. ("HDI"), in a public offering that took place on

March 31, 1994. Compl. ¶ 4. HDI conducts a mail-order retail business through numerous catalogs published by HDI, including *Domestications, Colonial Garden Kitchens, The Company Store, Hanover House, Gumps,* and *Tweeds.* Compl. ¶ 5.

At the public offering, Defendant, Sun Life Insurance Company of America ("SLIC"), sold 654,604 shares of common stock of HDI. Compl. ¶ 6. These shares were registered pursuant to a Form S-3 Registration Statement (No. 33-52353) ("Registration Statement") which became effective on March 31, 1994 and were offered for sale pursuant to a Prospectus dated March 30, 1994, distributed to the Plaintiff and others. Compl. ¶ 6. Each of the individually named Defendants is an executive of HDI who signed the Registration Statement. Compl. ¶¶ 7-18. Defendants, Merril, Lynch, Pierce, Fenner & Smith, Inc. ("Merril Lynch") and Alex Brown & Sons, Inc. ("Alex Brown"), acted as underwriters in connection with the public offering. Compl. ¶¶ 19-20.

On March 31, 1994, HDI common stock was publicly offered at $6.375 per share. On August 15, 1994, the day after HDI filed a 10-Q quarterly report for the quarter and six month period ended July 2, 1994, the closing price of its stock on the New York Stock Exchange was $4.06 per share, representing a decline in value of 36% over four and a half months. Compl. ¶¶ 61-62.

Plaintiff brings this suit as a class action under Federal Rules of Civil Procedure 23(a) and (b) (3) "on behalf of all persons other than defendants, their family members, agents, and affiliates, who purchased the common stock of HDI on the Public Offering or thereafter through and including August 15, 1994 and who suffered damages as a result . . ." Compl. ¶ 21. Plaintiff awaits class certification.

According to Plaintiff, Defendants violated applicable securities laws in connection with the public offering of HDI common shares held on March 31, 1994 because both the Registration Statement and the Prospectus were materially

false and misleading in violation of 15 U.S.C. §§ 77k and 771.

II. DISCUSSION

A. Standards Governing Motion to Dismiss

Federal Rule of Civil Procedure 12 (b) (6) allows a party to move for a dismissal based upon the pleader's "failure to state a claim upon which relief can be granted." Since the long-established federal policy of civil litigation is to decide cases on the proofs, district courts generally disfavor Rule 12(b) (6) motions. *Melo-Sonics Corp. v. Cropp*, 342 F.2d 856 (3d Cir. 1965); *Panek v. Bogucz*, 718 F. Supp. 1228, 1229 (D.N.J. 1989).

In deciding a motion to dismiss for failure to state a claim, all allegations in the pleadings must be accepted as true and the plaintiff must be given the benefit of every favorable inference that can be drawn from those allegations. *See Conley v. Gibson*, 355 U.S. 41, 48 (1957); *Wisniewski v. Johns-Manville Corp.*, 812 F.2d 81, 83 n.1 (3d Cir. 1987); *Markowitz*, 906 F.2d at 103. "All the rules require is a short and plain statement of the claim that gives the defendant fair notice of the plaintiff's claim and the grounds upon which it rests." *Conley*, 355 U.S. at 47.

Rule 12 (b) (6) does not countenance "dismissals based on a judge's disbelief of a complaint's factual allegations." *Neitzke v. Williams*, 490 U.S. 319, 326-27 (1989). "The issue is not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support the claims." *Scheur v. Rhodes*, 416 U.S. 232, 236 (1974).

Accepting the facts in the pleadings as true and giving them all reasonable inferences, a court must dismiss under Rule 12 (b) (6) "[i]f as a matter of law 'it is clear that no relief could be granted under any set of facts that could be proved consistent with the allegations.'" *Neitzke*, 490 U.S. at 326-27.

Ordinarily, when a court relies upon matters outside of the pleadings, it must convert the motion to dismiss into a motion

for summary judgment pursuant to Federal Rule of Civil Procedure 12 (c). An exception to this rule, however, permits a Court to consider documents that are referred to in the complaint. *E.g., Pension Benefit Guaranty Corp. v. White Consolidated Industries, Inc.*, 998 F.2d 1192, 1196-97 (3d Cir. 1993). Relying upon this exception, this Court will consider the Registration Statement, Prospectus, and 10-Q quarterly reports that are referred to in the Complaint and have been submitted as attachments to the declaration of Stephen R. Lang.

B. Alleged Securities Fraud

In Count I of the Complaint, Plaintiff alleges that Defendants violated section 11(a) of the Securities Act of 1933, which provides a cause of action to purchasers of securities where:

> any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact . . .necessary to make the statements therein not misleading. . .

15 U.S.C. § 77k(a).

In Count II of the Complaint, Plaintiff asserts that Defendants violated § 12 of the Securities Act of 1933, which authorizes a cause of action against:

> Any person who . . . offers or sells a security . . . by means of a prospectus . . . which includes an untrue statement of a material fact or omits to state a material fact necessary to make the statements, in light of the circumstances in which they were made, not misleading. . .

15 U.S.C. § 771(2).

Finally, Count III asserts a claim against Defendant Quasha under section 15 of the Securities Act of 1933, which establishes joint and several liability, subject to certain exceptions,

for "controlling persons" based upon violations of sections 11 and 12 of the Securities Act of 1933 that are committed by persons under their control. 15 U.S.C. § 77o. Plaintiff alleges that Quasha, as Chairman of the Board of Directors of HDI, was a controlling person responsible for the alleged violations contained in the Registration Statement and Prospectus. Compl. ¶¶ 71-72.

"At a minimum, each of the securities fraud provisions" allegedly violated by the Defendants "requires proof that the defendants made untrue or misleading statements or omissions of material fact." *In Re Donald J. Trump Casino Securities Litigation*, 7 F.3d 357, 368 (3d Cir. 1993), *cert. denied*, 114 S.Ct. 1219 (1994).

A statement or omission is material if there is "a substantial likelihood that, under the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder." *Renz v. Schreiber*, 832 F. Supp. 766, 775 (D.N.J. 1993) (citing *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)). *See also Trump Casino*, 7 F.3d at 368 n.10 (noting that materiality analysis for claims under §§ 10 and 10(b) of the Securities and Exchange Act of 1934 applies equally to claims under §§ 11 and 12 of the Securities Act of 1933). A fact is material if its disclosure would have "significantly altered the 'total mix' of information available." *Craftmatic Securities Litigation v. Kraftsow*, 890 F.2d 628, 641 (3d Cir. 1989). The materiality requirement is not met where the alleged omissions are "so obviously unimportant to an investor that reasonable minds cannot differ." *Trump Casino*, 7 F.3d at 369 n.13.

To avoid committing misrepresentation, a defendant is not required to disclose all known information, but only information that is "necessary to make other statements not misleading." *Id.* at 640. In other words, to state a cause of action, a plaintiff must identify "an affirmative statement that is made misleading by the material omission." *In Re Union Carbide Class Action Securities Litigation*, 648 F. Supp. 1322, 1326 (S.D.N.Y. 1986). Moreover, "the allegations of the complaint

are not read in isolation; they cannot be separated from the language of the prospectus, including whatever cautionary language appears in that text." *Trump Casino*, 793 F. Supp. 543, 553 (D.N.J 1992), *aff'd*, 7 F.3d 357 (3d Cir. 1993).

A court evaluates whether the statement or omission was misleading at the time it was made. *Trump Casino*, 793 F. Supp. at 553. "'[F]raud by hindsight,' the attempt to impose liability on management for unrealized economic predictions, is not actionable." *Id.* at 551 (quoting *Sinay v. Lamson & Sessions Co.*, 948 F.2d 1037, 1040 (6th Cir. 1991)).

Since the Prospectus, by its express terms, constitutes part of the Form S-3 Registration Statement filed with the Securities and Exchange Commission, the Court's discussion focuses upon the categories of misrepresentations alleged by the Plaintiff, rather than the counts of the Complaint or the type of document involved. *See* Lang Decl. Exh. 2 at 1. Plaintiff alleges that the Prospectus, incorporated by reference as part of the Registration Statement, was misleading in its omission of material information related to three topics: (1) HDI's rate of customer returns; (2) HDI's investments; and (3) HDI's proprietary customer lists.

1. HDI's Rate of Customer Returns

In the Prospectus/Registration Statement, HDI indicated that it maintained a policy of unconditionally guaranteeing its products and permitting dissatisfied customers to return merchandise "if not satisfied for any reason." Lang Decl. Exh. 2 at 29. In addition, HDI represented that the "return rate for 1993 was approximately 13% of gross shipments." Lang Decl. Exh. 2 at 29. The Prospectus/Registration Statement stated that the rate of returns in 1993 declined an unspecified amount in comparison to 1992. Lang Decl. Exh. 2 at 16.

According to Plaintiff, HDI's statement that 13% of its merchandise was returned by customers was allegedly false and misleading because the Prospectus/Registration Statement omitted the allegedly material fact that:

> by the time of the Offering the Company was experiencing a materially adverse trend with respect to returns. In fact, in the fiscal quarter ended April 2, 1994 -- a quarterly period which was more than 95% complete at the time of the Public Offering -- HDI had experienced a 15% increase in returns compared to the first quarter of 1993, that is, an increase from 13% of gross shipments in the first quarter of 1993 to 15% of gross shipments in 1994.

Compl. ¶ 43.

As a threshold matter, the Court notes that Plaintiff does not contest the accuracy of the 13% return rate in 1993. Instead, Plaintiff argues that the statement was misleading in light of HDI's increased rate of returns, 15%, during the first quarter of 1994. Implicitly, Plaintiff's claim rests upon the contention that HDI had a duty to disclose a negative trend in returns for the quarter that was in progress and largely completed when the Prospectus/Registration Statement became effective on March 30, 1994.

Even before a quarterly report is formally issued, a corporate official can probably be held liable for statements that are false or misleading in light of complete quarterly data that has become available but has not yet been made public. *Renz*, 832 F. Supp. at 781. Courts have been reluctant, however, to impose liability based upon a corporate official's failure to disclose financial data for a fiscal quarter in progress. *E.g., id.; In re Worlds of Wonder Securities Litigation*, 35 F.3d 1407, 1418-19 (9th Cir. 1994).

Where a corporate officer predicted a 17-18% growth in sales for an ongoing fiscal quarter seventeen days before the quarter closed, and the growth rate turned out to be 15%, 2% lower than his estimate, the court held that plaintiffs did not state a legitimate securities fraud claim. *Renz*, 832 F. Supp. at 781. The *Renz* court acknowledged, however, that if the official had predicted increased sales "after the end of the quarter on the basis of complete data covering the full quarter, though

before the third quarter report was actually released, our decision would probably have been different." *Id.*

Unlike the sales projection at issue in *Renz*, HDI's representation concerning the 13% return rate for 1993 was not a prediction but a statement of historical performance. The Prospectus and Registration did not speculate as to current rates of return during the quarter in progress. Furthermore, HDI did not predict future return rates or suggest that the 1993 rate was expected to continue. Therefore, the subsequent increase in the return rate during the first quarter of 1994, in progress at the time of the Public Offering, did not render this statement of historical fact illegally false or misleading. *See* 15 U.S.C. §§ 77k(a), 771(2).

Relying upon *Renz*, Plaintiff argues that because HDI's Prospectus/Registration Statement became effective less than three days before the close of the fiscal quarter, information regarding increased rate of returns must have been available and that HDI was obligated to disclose it. The existence of such an obligation is inconsistent with both *Renz* and the Ninth Circuit's decision in *Worlds of Wonder*. Both cases addressed projections of performance that failed to materialize. In *Renz* those projections were made publicly, while in *Worlds of Wonder*, they were made internally. *Renz,* 832 F. Supp. at 781; *Worlds of Wonder* 35 F.3d at 1418-19 (claim alleged that the prospectus failed to disclose how far sales were lagging behind internal sales projections for the quarter in progress when company's bonds were offered to the public). In both cases, plaintiffs did not succeed on their claims of false or misleading material omission. *Renz*, 832 F. Supp. at 781; *Worlds of Wonder*, 35 F.3d at 1418-19.

Plaintiff does not allege that Defendants made any public projections. In addition, Plaintiff attempts to distinguish *Worlds of Wonder* by expressly disavowing reliance upon any internal projections regarding rates of returns by HDI. Pl. Br. at 7.

In so doing, Plaintiff effectively concedes that the Complaint fails to allege that the Defendants' representation

that HDI's return rate for 1993 was 13% was false and misleading when it was made at the end of March, 1994. *See Renz*, 832 F. Supp. at 781 (citations omitted). Regardless of whether a public offering occurs seventeen or only two days before the close of a fiscal quarter, data concerning a quarter that is in progress is necessarily incomplete. As a result, HDI was incapable of making anything more than projections regarding return rates for the first quarter of 1994 on March 30 when its Prospectus and Registration Statement became effective. Plaintiff expressly disavows reliance upon any internal projections by HDI and has failed to identify any other source of this information that HDI was allegedly obligated to disclose.

Consequently, the Court is at a loss to identify what information relating to return rates existed during the first quarter of 1994 that was omitted from the Prospectus and Registration Statement, allegedly rendering the statements related to the return rate in 1993 misleading. *See In re Keegan Management Co. Securities Litigation*, 794 F. Supp. 939, 946 (N.D. Cal. 1992). Even if HDI had some duty to disclose financial data for a fiscal quarter in progress, Plaintiff has simply failed to allege any facts capable of supporting a reasonable inference that HDI's statement that the return rate for 1993 was 13% was misleading at the time it was made. *See Trump Casino*, 793 F. Supp. at 553.

Since Plaintiff has failed to establish, as a matter of law, that HDI made an affirmative statement in the Prospectus and Registration Statement related to the rate of return on HDI's merchandise that was misleading, this Court need not address materiality, the second element of a claim under sections 11(a) and 12. To the extent that Plaintiff's claims rely upon representations related to return rates, they are **dismissed.**

2. HDI's Investments

In addition, Plaintiff alleges that the Prospectus and Registration Statement were false and misleading because they omitted material facts related to the risks associated with HDI's investments in two companies, Boston Publishing

Company ("BPC") and Aegis Safety Holdings, Inc. ("Aegis"). According to Plaintiff, the Prospectus and Registration Statement failed to disclose the material fact that "BPC was in precarious financial straits on the date of the Public Offering . . . [which] caused a material risk to HDI of default by BPC." Compl. ¶ 48. BPC allegedly filed for bankruptcy in August, 1994, four months after the effective date of the Prospectus and Registration Statement. Compl. ¶ 49. Similarly, Plaintiff alleges that Aegis was in a precarious financial condition when the Prospectus and Registration Statement were issued, evidenced by HDI's disclosure in its 10-Q Statement for quarter the ending in July, 1994, that Aegis had breached certain loan covenants and that HDI "was negotiating a restructuring of the loan agreement." Compl. ¶ 51.

In determining whether a securities violation has occurred, the Court's inquiry appropriately begins with the affirmative statements contained in the Prospectus and Registration Statement allegedly made false or misleading by material omissions. *See In Re Union Carbide Class Action Securities Litigation,* 648 F. Supp. at 1326.

With respect to HDI's investment in BPC, the Prospectus/Registration Statement stated that HDI had acquired a 20% equity interest in BPC in February, 1994, in exchange for a "second three-year revolving credit facility of up to $3 million, a secured $.75 million short-term loan, and a $.5 million convertible note." Lang Decl. Exh. 2 at F-13. In addition, HDI agreed to provide BPC with access to HDI's proprietary customer lists and catalog production assistance. Lang Decl. Exh. 2 at 12, F-13. Finally, the Prospectus/Registration Statement represented that "BPC had approximately $12 million (unaudited) in revenues in 1993." Lang Decl. Exh. 2 at 12, F-13.

Regarding Aegis, the Prospectus/Registration Statement indicated that HDI had aquired 20% of Aegis' outstanding stock in exchange for financing by HDI. Long. Decl. at Exh. 2 at 11-12, F-13. Furthermore, the Prospectus/Registration Statement represented that "Aegis had approximately $9

million in net sales for the eleven months ended January 1, 1994." Long decl. Exh. 2 at 12, F-13.

Plaintiff does not contend that HDI misrepresented the terms of its agreement with either BPC or Aegis. Moreover, Plaintiff does not contend that Defendants made predictions about the future performance of either BPC or Aegis that did not subsequently materialize.

Rather, Plaintiff's claim apparently rests upon the contention that HDI's statements of BPC and Aegis' revenues, standing alone, were misleading because the Prospectus/Registration Statement omitted negative financial data that would have cast doubt upon BPC and Aegis's ability to meet their loan obligations to HDI. In other words, Plaintiff claims that the Prospectus/Registration Statement failed to disclose the allegedly material risks posed by HDI's investments in BPC and Aegis.

As an outgrowth of the requirement that a statement must be materially misleading at the time it was made for liability to attach, courts have held that:

> omissions that create a misleading impression -- particularly one that is misleading *only in hindsight* -- are not sufficient to constitute the basis of a securities action under section 11 or section 12(2).

In re Bank of Boston Securites Litigation, 762 F. Supp. 1525, 1538 (D. Mass. 1991) (citations omitted); *see also Speilman v. General Host Corp.*, 402 F. Supp. 190, 194 (S.D.N.Y. 1975), *aff'd*, 538 F.2d 39 (2d Cir. 1976) (per curiam). In order to prevail, a plaintiff must show that the omitted information in fact existed at the time that the allegedly misleading statement was made. *In re Keegan Management*, 794 F. Supp. at 946; *c.f. Laker v. Freid*, 854 F. Supp. 923, 931 (D. Mass. 1994) (plaintiff must do more that make general averments of falsity to support 10b-5 claim; plaintiff must set forth specific facts to show statement was materially misleading). "Even section 11 . . . , 15 U.S.C. § 77k, which provides strict liability against the issuer of stock for misstatements in the

prospectus, does not impose liability for the omission of material information which was unknown to, and not reasonably discoverable by, the defendants." *In re Keegan Management,* 794 F. Supp. at 946.

In the Complaint, Plaintiff does not allege any specific facts that directly support the claim that BPC and Aegis were in "precarious" financial condition when the public offering occurred on March 31, 1994. Rather, Plaintiff relies upon an inference based upon subsequent events. Plaintiff argues that Aegis' breach of certain loan covenants and BPC's bankruptcy, both revealed in HDI's 10-Q statement, effective August 15, 1994, indicates that both companies must have been financially unsound four months before, when the public offering occured.

In opposition to dismissal, Plaintiff argues that courts routinely permit subsequent filings with the Securities and Exchange Commission (SEC) to provide the basis for securities fraud claims. *E.g., Robbins v. Moore Medical Corp.,* 788 F. Supp. 179 (S.D.N.Y. 1992); *Serls v. Glasser,* Fed. Sec. L. Rep. (CCH) ¶ 97,358 (N.D. Ill. 1993) (unpublished).

In several of the cases relied upon by Plaintiff, the defendant made predictions in a prospectus or registration statement that were not borne out by subsequent events. *E.g., Robbins,* 788 F. Supp. at 182, 192 (statements "misleading in both their affirmative optimism and in the omission of known problems. . ."); *Laker,* 854 F. Supp. at 931 (defendant knew of company's problems before it made positive predictions).

In others, a defendant's subsequent filings with the SEC revealed the negative consequences of actions taken by the defendant before the prospectus or registration statement was issued, actions specifically identified in the complaint. *See Nicholas v. Poughkeepsie Sav. Bank FSB,* Fed. Sec. L. Rep. (CCH) ¶ 95,606 (S.D.N.Y. 1990) (bank officers altered loan/loss reserves before prospectus issued) (unpublished); *Diamond v. Fogelman,* cv 90-0900 at 35-37 (E.D.N.Y. 1991) (unpublished) (defendant did not disclose that he was guarantor on prior real estate projects, which had diminished his

ability to satisfy personal guaranty described in registration statement and prospectus).

In contrast, HDI's Prospectus/Registration Statement did not make any predictions regarding the future performance of BPC or Aegis. Furthermore, the Prospectus/Registration Statement did not characterize the risk involved in these investments. The Prospectus/Registration Statement merely set forth the fact of BPC and Aegis' past revenues. Without being connected to some prediction or evaluation of risk associated with these investments, the statements reporting BPC and Aegis' purely historical revenue performance were not rendered misleading by subsequent events.

Federal securities law does not require disclosure of facts that are not purely hypothetical or not reasonably discoverable by the defendant. *See General Electric Co. by Levit v. Cathcart,* 980 F.2d 927, 935 (3rd Cir. 1992); *In re Keegan Management,* 794 F. Supp. at 946. A defendant is not obligated to predict future events, absent some reason to believe that they will occur. *In re Ultimate Corp. Securites Litigation,* Fed. Sec. L. Rep. ¶ 94,522 (S.D.N.Y. 1989) (unpublished).

Since Plaintiff has failed to allege any fact that shows that BPC and Aegis were in "precarious" financial condition when the Propspectus and Registration Statement became effective at the end of March, 1994, she has failed to state a claim that the statements related to the companies' past revenue were materially false or misleading in violation of sections 11(a) and 12(2). Plaintiff's allegations are based entirely upon hindsight: the problems with these two companies that were revealed in HDI's 10-Q report dated August 15, 1994. *See In re Bank of Boston Securities Litigation,* 762 F. Supp. at 1538. To the extent that Plaintiff's claims rest upon alleged misrepresentations related to HDI's investments in BPC and Aegis, they are **dismissed.**

3. HDI's Proprietary Customer Lists

According to Plaintiff, HDI's Prospectus/Registration Statement contained materially false and misleading

statements related to HDI's proprietary customer lists. Initially Plaintiff alleged in her Complaint that statements characterizing HDI's proprietary customer lists as containing a high percentage of "tested" customers, who had previously purchased from a catalogue owned by HDI, were false and misleading. Compl. ¶¶ 52, 59. In addition, Plaintiff alleged that the Prosepectus and Registration Statement omitted the material fact that HDI's proprietary mailing list "was inadequate to support the Company's stated growth plans" and that HDI would need to resort to "blind mailings." Compl. ¶ 60.

In support of this motion to dismiss, Defendants cite numerous passages from the Prospectus and Registration Statement that contradict Plaintiff's allegations. Def. Br. at 25-28. The statements cited by Defendants suggest that a reasonable investor would have interpreted the Propspectus and Registarion Statement as indicating that HDI planned to solicit new customers not on any prior mailing lists. In addition, Defendants demonstrated that, contrary to Plaintiff's suggestion, the Propspectus and Registration Statement did not make any predictions regarding future response rates to HDI mailings or their impact on the company's growth.

In the opposition brief, Plaintiff has not reasserted its claims based upon these alleged misrepresentations or made any arguments based upon these facts. Instead, Plaintiff's opposition rests solely upon Defendants' alleged failure to disclose that during the first quarter of 1994, which ended three days before the Prospectus and Registration Statement became effective, HDI's substantial increase in new mailings yielded lower revenues and response rates in comparison to a similair period during 1993. Compl. ¶ 61. HDI disclosed this downturn in its second quarter 10-Q report, dated August 15, 1994. Since Plaintiff has implicitly abandoned her other allegations related to the proprietary mailing lists as supportive of her claims, this single allegation is before the Court.

For the same reasons that Plaintiff's allegation that the Prospectus and Registration Statement failed to disclose a material adverse trend in returns could not support her claims, this

allegation of lower response rates to catalogue mailings during the first quarter of 1994 is also deficient. Defendants did not have a duty to disclose data from an ongoing fiscal quarter. *See Renz*, 832 F. Supp. at 781; *In re Keegan Management*, 794 F. Supp. at 946; *Worlds of Wonder*, 35 F.3d at 1418-19. Even if Defendants had such an obligation, Plaintiff has not demonstrated that any compiled information in fact existed that could not have been disclosed. *In re Keegan Management*, 794 F. Supp. at 946. Moreover, the Prospectus and Registration Statement did not make any predictions regarding response rates for the first quarter of 1994 that did not materialize. In fact, the statements that were contained in the Prospectus and Registration Statement indicated that HDI "had experienced lower response rates related principally to an agressive customer acquisition campaign" in 1993. Lang Decl. Exh. 2 at 17.

Where a prospectus "does in fact describe the marketing strategy which the [Company] planned to utilize . . . [i]n conjunction with statements concerning the intensity of . . . competition [within the industry] . . . these disclosures sufficed to inform the reasonable investor that the [Company] would need to expend substantial sums in its efforts to attract patrons. . ." *Trump Casino*, 7 F.3d at 376 n.21.

Applying these standards, the Prospectus and Registration Statement provided sufficient information to apprise the reasonable investor of the obvious risk that HDI's solicitation of new customers might result in lower response rates. The Prospectus and Registration Statement also indicated that HDI had acquired three previously underperforming new catalogues, as well as the rights to use the mailing list containing 23 million names from the discontinued Sears catalogue. Furthermore, the Prospectus and Registration Statement warned that the mail-order catalogue industry was "highly competitive." Lang Decl. Exh. 2 at 8. In light of these detailed disclosures, a statement that there was a risk that HDI would experience a lower response rate was unnecessary. *See Trump Casino*, 7 F.3d at 374-75.

Under these circumstances, the Court concludes that the statements contained in the Prospectus and Registration Statement regarding the response rate to HDI's catalogue mailings were not false or misleading when made. To the extent that Plaintiff's claims rely upon allegedly false or misleading information related to response rates, they are dismissed.

4. Claims Against Defendant Quasha

In Count III of the Complaint, Plaintiff asserts a claim against Defendant Quasha as a "controlling person" responsible for violations of sections 11 and 12 by his subordinates. *See* 15 U.S.C. § 77o. Since this Court has found that no violations of section 11 or 12 occurred, there is no basis for controlling person liability. Consequently, Count III of Plaintiff's Complaint is dismissed.

4. Plaintiff's Request to Amend the Complaint

In a footnote, Plaintiff requests the Court to grant her leave to file an amended complaint in the event that any portion of the Complaint is found deficient.

Plaintiff's request for leave to amend is denied for three reasons. First, the request is not properly before the Court by way of a notice of motion. Second, Plaintiff has not submitted a copy of the proposed amended complaint in accordance with Local Rule 12H. Third, the Court finds that such an amendment would be futile and is therefore unwarranted. *See e.g., Trump Casino*, 793 F. Supp. at 568.

III. CONCLUSION

Defendants' motion to dismiss is granted. An appropriate Order accompanies this Opinion.

Dated: July 6, 1995

/s/ William G. Bassler

WILLIAM G. BASSLER, U.S.D.J.

Appendix C

Section 11 of Securities Act of 1933

Civil Liabilities on Account of False Registration Statement

Sec. 11. (a) In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue —

(1) every person who signed the registration statement;

(2) every person who was a director of (or person performing similar functions) or partner in, the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted;

(3) every person who, with his consent, is named in the registration statement as being or about to become a director, person performing similar functions, or partner;

(4) every accountant, engineer, or appraiser or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him;

(5) every underwriter with respect to such security.

If such person acquired the security after the issuer has made generally available to its security holders an earning statement covering a period of at least twelve months beginning after the effective date of the registration statement, then the right of recovery under this subsection shall be conditioned on proof that such person acquired the security relying upon such untrue statement in the registration statement or relying upon the registration statement and not knowing of such omission, but such reliance may be established without proof of the reading of the registration statement by such person.

(b) Notwithstanding the provisions of subsection (a) no person, other than the issuer, shall be liable as provided therein who shall sustain the burden of proof —

(1) that before the effective date of the part of the registration statement with respect to which his liability is asserted (A) he had resigned from or had taken such steps as are permitted by law to resign from, or ceased or refused to act in, every office, capacity, or relationship in which he was described in the registration statement as acting or agreeing to act, and (B) he had advised the Commission and the issuer in writing that he had taken such action and that he would not be responsible for such part of the registration statement; or

(2) that if such part of the registration statement became effective without his knowledge, upon becoming aware of such fact he forthwith acted and advised the Commission, in accordance with paragraph (1), and, in addition, gave reasonable public notice that such part of the registration statement had become effective without his knowledge; or

(3) that (A) as regards any part of the registration statement not purporting to be made on authority of an expert, and not purporting to be a copy of or extract from a report or valuation of an expert, and not purporting to be made on the authority of a public official document or statement, he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading; and (B) as regards any part of the registration statement purporting to be made upon his authority as an expert or purporting to be a copy of or extract from a report or valuation of himself as an expert, (i) he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state material fact required to be stated therein not misleading, or (ii) such part of the registration statement did not fairly represent his statement as an expert or was not a fair copy of or extract from his report or valuation as an expert; and (C) as regards any part of the registration statement purporting to be made on the authority of an expert (other than himself) or purporting to be a copy of or extract from a report or valuation of an expert (other than himself), he had no reasonable ground to believe and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or that such part of the registration statement did not fairly represent the statement of the expert or was not a fair copy of or extract from the report or valuation of the

expert; and (D) as regards any part of the registration statement purporting to be a statement made by an official person or purporting to be a copy of or extract from a public official document, he had no reasonable ground to believe and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue, or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or that such part of the registration statement did not fairly represent the statement made by the official person or was not a fair copy of or extract from the public official document.

(c) In determining, for the purpose of paragraph (3) of subsection (b) of this section, what constitutes reasonable investigation and reasonable ground for belief, the standard of reasonableness shall be that required of a prudent man in the management of his own property.

(d) If any person becomes an underwriter with respect to the security after that part of the registration statement with respect to which his liability is asserted had become effective, then for the purposes of paragraph (3) of subsection (b) of this section such part of the registration statement shall be considered as having become effective with respect to such person as of the time when he became an underwriter.

(e) The suit authorized under subsection (a) of this section may be to recover such damages as shall represent the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and (1) the value thereof as of the time such suit was brought, or (2) the price at which such security shall have been disposed of in the market before suit, or (3) the

price at which such security shall have been disposed of after suit but before judgment if such damages shall be less than the damages representing the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and the value thereof as of the time such suit was brought: Provided, that if the defendant proves that any portion or all of such damages represents other than the depreciation in value of such security resulting from such part of the registration statement, with respect to which his liability is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statements therein not misleading, such portion of or all such damages shall not be recoverable. In no event shall any underwriter (unless such underwriter shall have knowingly received from the issuer for acting as an underwriter some benefit, directly or indirectly, in which all other underwriters similarly situated did not share in proportion to their respective interests in the underwriting) be liable in any suit or as a consequence of suits authorized under subsection (a) of this section for damages in excess of the total price at which the securities underwritten by him and distributed to the public were offered to the public. In any suit under this or any other section of the subchapter the court may, in its discretion, require an undertaking for the payment of the costs of such suit, including reasonable attorney's fees, and if judgment shall be rendered against a party litigant, upon the motion of the other party litigant such costs may be assessed in favor of such party litigant (whether or not such undertaking has been required) if the court believes the suit or the defense to have been without merit, in an amount sufficient to reimburse him for the reasonable expenses incurred by him, in connection with such suit, such costs to be

taxed in the manner usually provided for taxing of costs in the court in which the suit was heard.

(f) All or any one or more of the persons specified in subsection (a) shall be jointly and severally liable, and every person who becomes liable to make any payment under this section may recover contribution as in cases of contract from any person who, if sued separately, would have been liable to make the same payment, unless the person who has become liable was, and the other was not, guilty of fraudulent misrepresentation.

(g) In no case shall the amount recoverable under this section exceed the price at which the security was offered to the public.

Appendix D

FORM S-3

SECURITIES AND EXCHANGE COMMISSION

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

Item 11. Material Changes

(a) Describe any and all material changes in the registrant's affairs which have occurred since the end of the latest fiscal year for which certified financial statements were included in the latest annual report to security holders and which have not been described in a report on form 10–Q or form 8–K filed under the Exchange Act.

(b) Include in the prospectus, if not incorporated by reference therein from the reports filed under the Exchange Act specified in Item 12(a), a proxy or information statement filed pursuant to Rule 424(b) or (c) under the Securities Act or, where no prospectus was required to be filed pursuant to Rule 424(b), the prospectus included in the registration statement at effectiveness, or a Form 8–K filed during either of the two preceding years: (i) information required by Rule 3–05 and Article 11 of Regulations S-X; (ii) restated financial statements prepared in accordance with Regulation S-X if there has been a change in accounting principles or a correction in an error where such change or correction requires a material retroactive restatement of financial statements; (iii) restated financial statements prepared in accordance with Regulation S-X where on or more business combinations accounted for by the pooling of interest method of accounting have been consummated subsequent to the most recent fiscal year and the acquired businesses, considered in the aggregate, are significant pursuant to Rule 11–01(b), or (iv) any financial information required because of a material disposition of assets outside the normal course of business.

No. 95-2080 (2)

In The

Supreme Court of the United States

Supreme Court, U.S.
FILED
AUG 12 1996
CLERK

October Term, 1995

VERONICA ZUCKER, individually and on behalf of a class of others similarly situated,

Petitioner,

vs.

ALAN G. QUASHA, JACK E. ROSENFELD, RALPH DESTINO, J. DAVID HAKMAN, S. LEE KLING, THEODORE H. KRUTTSCHNITT, JEFFREY LAIKIND, ELIZABETH VALK LONG, EDMUND R. MANWELL,

(Continued)

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

RESPONDENTS' BRIEF IN OPPOSITION

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GERALDINE STUTZ, ROBERT F. WRIGHT, WAYNE P. GARTEN, HANOVER DIRECT INC., SUN LIFE INSURANCE COMPANY OF AMERICA, MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., ALEX BROWN & SONS, INC., individually and on behalf of a class of underwriters similarly situated,

Respondents.

CORPORATE DISCLOSURE STATEMENT

Respondents Hanover Direct, Inc., Sun Life Insurance Company of America, Merrill Lynch, Pierce, Fenner & Smith, Inc., and Alex Brown & Sons, Inc. make this statement pursuant to Rule 29.6 of the Rules of the Supreme Court.

HANOVER DIRECT, INC. SUBSIDIARIES AND AFFILIATES

Aegis Catalog Corporation	Delaware
Aegis Retail Corporation	Delaware
Aegis Safety Holdings, Inc.	Delaware
Aegis Ventures, Inc.	Delaware
American Down & Textile Company	Wisconsin
The Austad Company	South Dakota
Austad Holdings, Inc.	Delaware
BC of Tennessee	Tennessee
Brawn of California, Inc.	California
Brawn Wholesale Corp.	California
Company Store Holdings, Inc.	Delaware
The Company Factory, Inc.	Wisconsin

The Company Office, Inc.	Wisconsin
The Company Store, Inc.	Wisconsin
D.M. Advertising, Inc.	New Jersey
Gump's By Mail	Delaware
Gump's Catalog, Inc.	Delaware
Gump's Corp.	California
Gump's Holdings, Inc.	Delaware
H&H 1600 Broadway Corporation	New York
H.H.B.K. 45th Street Corporation	New York
H.H.B.K., Inc.	New York
Hanover Casuals, Inc.	Delaware
Hanover Catalog Holdings, Inc.	Delaware
Hanover Direct Mail Marketing, Inc.	Pennsylvania
Hanover Direct Pennsylvania, Inc.	Pennsylvania
Hanover Direct Virginia, Inc.	Delaware
Hanover Finance Corporation	Delaware
Hanover List Management, Inc.	New Jersey

Hanover Realty, Inc.	Virginia
Hanover Syndication Corporation	Pennsylvania
Hanover Ventures, Inc.	Delaware
Henre, Inc.	Delaware
The Horn & Hardart Company, Inc.	New York
The Horn & Hardart Consulting Corporation	New York
The Horn & Hardart Realty Company, Inc.	New York
LWI Holdings, Inc.	Delaware
LWI Retail, Inc.	Ohio
Leichtung of Michigan, Inc.	Michigan
Scandia Down Corporation	Delaware
Software Investment Corporation	Delaware
Tweeds, Inc.	Delaware
Tweeds of Vermont, Inc.	Delaware
York Fulfillment Company, Inc.	Pennsylvania

MERRILL LYNCH & CO. INC.
SUBSIDIARIES AND AFFILIATES

Merrill Lynch & Co., Inc.	Delaware
Merrill Lynch, Pierce, Fenner & Smith Incorporated	Delaware
Broadcort Capital Corp.	Delaware
Merrill Lynch & Co., Canada Ltd.	Ontario
Merrill Lynch Canada Incorporated/ Incorporee	Nova Scotia
Merrill Lynch Life Agency Inc.	Washington
Wagner Stott Clearing Corp.	Delaware
Merrill Lynch Bank & Trust Co.	New Jersey
Merrill Lynch Capital Services, Inc.	Delaware
Merrill Lynch Government Securities Inc.	Delaware
Merrill Lynch Money Markets Inc.	Delaware
Merrill Lynch Group, Inc.	Delaware
Merrill Lynch Capital Partners, Inc.	Delaware
Merrill Lynch Derivative Products, Inc.	Delaware
Merrill Lynch Futures Inc.	Delaware

Merrill Lynch Group Holdings Limited	Ireland
Merrill Lynch Capital Markets Bank Limited	Ireland
Merrill Lynch Insurance Group, Inc.	Delaware
Merrill Lynch Life Insurance Company	Arkansas
ML Life Insurance Company of New York	New York
Merrill Lynch International Finance Corporation	New York
Merrill Lynch International Bank Limited	England
Merrill Lynch Bank (Suisse) S.A.	Switzerland
Merrill Lynch Mortgage Capital Inc.	Delaware
Merrill Lynch National Financial	Utah
Merrill Lynch Trust Bank of Michigan	Michigan
Merrill Lynch Trust Company	New Jersey
Merrill Lynch Business Financial Services Inc.	Delaware
Merrill Lynch Credit Corporation	Delaware
Merrill Lynch Home Equity Acceptance, Inc.	Delaware

Merrill Lynch Trust Company	Florida
Merrill Lynch Financial Data Services, Inc.	Florida
Merrill Lynch Trust Company of America	Illinois
Merrill Lynch Trust Company of California	California
Merrill Lynch Trust Company of Texas	Texas
Merrill Lynch Investment Partners Inc.	Delaware
ML IBK Positions Inc.	Delaware
Merrill Lynch Capital Corporation	Delaware
ML Leasing Equipment Corp.	Delaware
Princeton Services, Inc.	Delaware
Merrill Lynch International Incorporated	Delaware
Merrill Lynch International (Australia) Limited	New South Wales
Merrill Lynch International Bank	United States
Merrill Lynch International Holdings Inc.	Delaware
Merrill Lynch Bank (Austria) Aktiengesellschaft A.G.	Austria
Merrill Lynch Bank and Trust Company (Cayman) Limited	Cayman Islands, British West Indies

Merrill Lynch International & Co.	Netherlands Antilles
Merrill Lynch Capital Markets A.G.	Switzerland
Merrill Lynch Europe PLC	England
Merrill Lynch International Limited	England
Merrill Lynch Capital Markets PLC	England
Merrill Lynch, Pierce, Fenner & Smith (Brokers & Dealers) Limited	Engl
Merrill Lynch Trust Company (Jersey) Limited	Jersey, Channel Islands
Merrill Lynch Europe Ltd.	Cayman Islands, British West Indies
Merrill Lynch Holding GmbH	Germany
Merrill Lynch Bank A.G.	Germany
Merrill Lynch GmbH Germany Merrill Lynch Holding S.A.F.	France
Merrill Lynch Capital Markets (France) S.A.	France
Merrill Lynch Far East Limited	Hong Kong
Merrill Lynch Japan Incorporated	Delaware

ALEX.BROWN & SONS INCORPORATED PARENT ENTITIES AND SUBSIDIARIES

Alex. Brown Incorporated (parent)	Maryland
Alex.Brown & Sons Incorporated	Maryland
Alex.Brown & Sons Holding Limited	United Kingdom
Alex.Brown & Sons Investments Limited	United Kingdom
Alex.Brown & Sons Finance Limited	Maryland
Alex.Brown & Sons Limited	United Kingdom
Alex.Brown & Sons Financial Corporation	Delaware
Alex.Brown & Sons Capital Advisory Incorporated	Maryland
Investment Company Capital Corp.	Maryland
Brown & Glenmede Holdings Inc.	Maryland
Alex.Brown Capital Advisory & Trust Company	Maryland
BAT Commingled Fund Manager Inc.	Maryland
Alex.Brown Insurance Agency Incorporated	Maryland
Alex.Brown Insurance Agency of Mass. Inc.	Massachusetts

Alex.Brown Investments Incorporated	Maryland
ABS MB Ltd.	Maryland
TC Trustees Limited	United Kingdom
Alex.Brown Management Services, Inc.	Maryland
Alex.Brown Leasing Services Incorporated	Maryland
ABS Leasing Services Company	Illinois
Alex.Brown Mortgage Capital Corporation	Maryland
Alex.Brown Financial Services Incorporated	Maryland
Argent Incorporated	Maryland
AB Administrative Partner, Inc.	Maryland

SUN LIFE INSURANCE COMPANY OF AMERICA PARENT ENTITIES, SUBSIDIARIES AND AFFILIATES

Note: Effective July 7, 1995, Sun Life Insurance Company of America changed its name to SunAmerica Life Insurance Company.

SunAmerica, Inc. (parent corporation)	Arizona
SunAmerica Life Insurance Company	Arizona
SunAmerica Funding Corp.	Delaware

AMSUN Realty Holdings	California
SunAmerica Marketing, Inc.	Maryland
SunAmerica Advertising, Inc.	Georgia
SunAmerica Investments, Inc.	Delaware
Accelerated Capital Corp.	Florida
1401 Sepulveda Corp.	California
SunAmerica Louisiana Properties, Inc.	California
SunAmerica Real Estate and Office Administration, Inc.	Delaware
SunAmerica Affordable Housing Partners, Inc.	California
SUN-PLA, Inc.	California
Hampden I & II Corp.	California
Sunport Holdings, Inc.	California
Sunport Property Co.	Florida
Sun Chino Property, Inc.	California
SunAmerica Mortgages, Inc.	Delaware
Sun Princeton I, Inc.	California
Sun Princeton II, Inc.	California

Advantage Capital Corporation	New York
SunAmerica Financial, Inc.	Georgia
SunAmerica Planning, Inc.	Maryland
SunAmerica Securities, Inc.	Delaware
Anchor Insurance Services, Inc.	Hawaii
Sun Mexico Holdings, Inc.	Delaware
Sun Cancun I, Inc.	Delaware
Sun Cancun II, Inc.	Delaware
Sun Ixtapa I, Inc.	Delaware
Sun Ixtapa II, Inc.	Delaware
Sun Hechs, Inc.	California
SunAmerica Travel Services, Inc.	California
SAI Investment Adviser, Inc.	Delaware
Resources Trust Company	Colorado
KBHS, Inc.	California
Home Systems Partners, a California Ltd. Partnership	California
Extraneous Holdings Corp.	Delaware

Sun Royal Holdings Corporation	California
Royal Alliance Associates, Inc.	Delaware
First SunAmerica Life Insurance Company	New York
SunAmerica National Life Insurance Company	Arizona
Anchor National Life Insurance Company	Arizona
Anchor Pathway Fund (a Massachusetts business trust)	Massachusetts
Anchor Series Trust (a Massachusetts business trust)	Massachusetts
SunAmerica Series Trust (a Massachusetts business trust)	Massachusetts
Saamsun Holdings Corp.	Delaware
SAM Holdings Corporation	California
SunAmerica Asset Management Corp.	Delaware
Anchor Investment Adviser, Incorporated	Maryland
SunAmerica Capital Services, Inc.	Delaware
SunAmerica Fund Services, Inc.	Delaware
ANF Property Holdings, Inc.	California

Capitol Life Mortgage Corp.	Delaware
UG Corporation	Georgia
Export Leasing FSC, Inc.	U.S. Virgin Islands
SunAmerica Virginia Properties, Inc.	California
SunAmerica Realty Partners	California
SAL Investment Group, Inc.	California
CalFarm Life Insurance Company	California
Ford Life Insurance Company	Michigan
Sun Quorum LLC	Delaware
Imperial Premium Finance, Inc.	Delaware
Imperial Premium Finance, Inc.	California
SunAmerica Financial Resources, Inc.	Delaware
IPF Funding Corp.	Delaware
SA Investment Group, Inc.	California
SunAmerica Capital Trust I	Delaware
SunAmerica Capital Trust II	Delaware
SunAmerica Capital Trust III	Delaware

SunAmerica Capital Trust IV	Delaware
Stanford Ranch, Inc.	Delaware
Stanford Ranch, Inc.	California
New California Life Holdings, Inc.	Delaware
Aurora National Life Assurance Company	California

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Hanover Direct, Inc., Sun Life Insurance Company of America, Alan G. Quasha, Jack E. Rosenfeld, Ralph Destino, J. David Hackman, S. Lee Kling, Theodore H. Kruttschnitt, Jeffrey Laikind, Elizabeth Valk Long, Edmund R. Manwell, Geraldine Stutz, Robert F. Wright, Wayne P. Garten, Merrill Lynch, Pierce Fenner & Smith, Inc. and Alex Brown & Sons, Inc. (collectively, "Respondents"), oppose the Petition for Writ of Certiorari filed by Veronica Zucker ("Petitioner").

STATEMENT OF THE CASE

A. The Complaint

This case arose out of a public offering of 8 million shares of Hanover Direct, Inc. ("Hanover") common stock pursuant to a registration statement and prospectus filed March 30, 1994 (the "Prospectus"). Hanover is a direct specialty retailer which publishes a portfolio of 14 branded and specialty catalogs offering home furnishings, general merchandise and apparel. On March 31, 1994 petitioner allegedly purchased 3,000 shares of Hanover common stock at a price of $6.375 per share. Approximately four and a half months later, on August 15, 1994, Hanover's common stock is alleged to have traded at $4.06 per share.

Petitioner filed a Complaint in the United States District Court for the District of New Jersey on September 2, 1994 asserting claims under sections 11, 12(2) and 15 of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. §§ 77k, 77l(2) and 77o. The Complaint did not allege that the Prospectus contained a single false or misleading affirmative statement of fact but rather alleged that the Prospectus was materially misleading because it omitted allegedly material information concerning,

inter alia, the rate of returns of merchandise by Hanover's customers.[1]

The Prospectus, which was filed prior to the completion of the first quarter, disclosed that Hanover has a return policy which permits customers to return merchandise for a refund if not satisfied for any reason. The Prospectus further disclosed that the rate of such returns for the entire calendar year 1993 was approximately 13% of gross shipments. Petitioner did not allege that the disclosure of historical performance for calendar year 1993 was false. Nor did she allege that Hanover made any prediction, one way or another, regarding the future anticipated rate of return. Rather, Petitioner asserted that the March 30 Prospectus was misleading because Hanover's April 1994 10-Q, dated May 16, 1994, disclosed that, for the first quarter ending on April 2, 1994, the rate of returns was 15%, and that this rate purportedly constituted a material adverse "trend" which should have been disclosed in the Prospectus.

The Prospectus advised investors not only of the inherent uncertainties and intense competition in the direct retailing business, but also of the risks and problems associated with Hanover's most recent acquisition of three non-profitable catalogs. The Prospectus did not contain any representations or predictions regarding any future rate of growth, sales, revenues or profits.

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1. Petitioner also argued to the court below that the Prospectus was misleading because it omitted allegedly material information concerning Hanover's limited investment in two companies and Hanover's proprietary customer list. The district court properly dismissed Petitioner's Complaint with respect to each of those claimed material omissions, and Petitioner does not here assert error or a conflict between the circuit courts with respect to the disposition of those claims.

B. The Proceedings Below

In *Zucker v. Quasha*, 891 F. Supp. 1010 (D.N.J. 1995) the district court applied the settled principle that a plaintiff alleging an omission of material fact must identify " 'an affirmative statement that is made misleading by the material omission.'" 891 F. Supp. at 1014 (quoting *In re Union Carbide Class Action Sec. Litig.*, 648 F. Supp. 1322, 1326 (S.D.N.Y. 1986)). Accepting the allegations of Petitioner's complaint as true, the court held that Petitioner "failed to establish, as a matter of law, that [Hanover] made an affirmative statement in the Prospectus and Registration Statement relating to the rate of return on [Hanover's] merchandise that was misleading. . . ." 891 F. Supp. at 1016.

The court stated that Hanover's representation concerning the 13% return rate for calendar year 1993 was a "statement of historical performance" which Petitioner did not contest. *Id.* at 1015. Further, the court noted that Hanover "did not speculate as to current rates of return during the quarter in progress" and "did not predict future return rates or suggest that the 1993 rate was expected to continue." *Id.* Accordingly, the fact that the Prospectus did not discuss or mention a 2% rise in the return rate during a then incomplete fiscal quarter "did not render [the] statement of historical fact illegally false or misleading." *Id.*

The court further held that even if there was a duty to disclose data from an incomplete quarter, Petitioner failed to demonstrate that any compiled information or projections in fact existed which could have been disclosed, or which Petitioner could have relied on. 891 F. Supp. at 1016. Consequently, the court was "at a loss" to identify what information relating to return rates during the incomplete first quarter of 1994 was omitted from the Prospectus, which rendered the statements relating to the return rate in 1993 false and misleading. *Id.*

The Third Circuit Court of Appeals affirmed the decision of the District Court without opinion. 82 F.3d 408 (3d Cir. 1996) (Table No. 95-5428).

REASONS FOR DENYING THE WRIT

I.

THERE IS NO CONFLICT BETWEEN THE CIRCUITS REGARDING THE DISCLOSURE OF INTERIM FINANCIAL RESULTS FROM AN INCOMPLETE FISCAL QUARTER.

The sole reason advanced by Petitioner for the grant of certiorari is that this case purportedly presents "an important question in which there is a direct conflict among the Circuits." (Petition at 3). There is no such conflict. The Petition misstates both the decision of the court below, as well as the decision in *Shaw v. Digital Equipment Corp.*, 82 F.3d 1194 (1st Cir. 1996) in an effort to manufacture a "direct conflict" suitable to warrant certiorari. In fact, the First Circuit Court of Appeals in *Shaw* expressly distinguished *Zucker v. Quasha* on its facts, further underscoring the lack of any conflict between the circuit courts.

This case, like the *Shaw* case, turns on its own unique facts, involves the application of settled, noncontroversial principles of law and does not raise any serious issues under the federal securities laws.

A. Neither *Zucker v. Quasha* Nor *Shaw v. Digital Equipment Corp.* Adopted An Inflexible Rule Regarding The Disclosure Of Financial Data From An Incomplete Quarter.

Petitioner's argument for review of the opinion of the court below rests on the unsupported assertion that "the District Court adopted a 'complete fiscal period' rule," and that pursuant to that

rule, a seller of securities is never under a duty to disclose incomplete quarterly data. (Petition at 7). But the district court never adopted such an inflexible "rule."

The court noted that courts have been "reluctant to impose liability based upon a corporate official's failure to disclose financial data for a fiscal quarter in progress." 891 F. Supp. at 1015 (citing *In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1418-19 (9th Cir. 1994); *Renz v. Schreiber*, 832 F. Supp. 766, 781 (D.N.J. 1993)). Consistent with those decisions, the court was unwilling to find that such a duty to disclose incomplete financial data was triggered in this case, given the factual allegations of the complaint.

Indeed, despite those decisions, the court nonetheless assumed, *arguendo*, that there might be such a duty to disclose interim quarterly data, and still found nothing to support Petitioner's claims that Hanover's disclosures were misleading. The court held that "[e]ven if [Hanover] had some duty to disclose financial data for a fiscal quarter in progress," petitioner "simply failed to allege any facts capable of supporting a reasonable inference that [Hanover's] statement that the return rate for 1993 was 13% was misleading at the time it was made." 891 F. Supp. at 1016.[2]

Just as the court below did not set forth any *per se* rule with respect to disclosure of incomplete quarterly data, the court in

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2. *Accord In re Wells Fargo Securities Litigation*, 12 F.3d 922, 930 (9th Cir. 1993) (factually accurate statements of positive historical results do not create the impression of future continued positive results); *In re Marion Merrell Dow, Inc. Securities Litigation*, [1994-95 Transfer Binder], Fed. Sec. L. Rep. (CCH) ¶98,357 (W.D. Mo. 1994) (same); *In re Verifone Sec. Litig.*, 784 F. Supp. 1471, 1484 (N.D. Cal. 1992), *aff'd sub. nom. Halkin v. Verifone*, 11 F.3d 865 (9th Cir. 1993) (same).

Shaw v. Digital Equipment Corp., supra, specifically *declined* to adopt a "hard and fast rule" regarding the disclosure of interim financial information. 82 F.3d at 1210. There, purchasers of securities of Digital Equipment Corp. ("DEC") brought suit alleging securities fraud in connection with a public offering conducted pursuant to a "shelf registration statement" under SEC Rule 415(a). The offering commenced on March 21, 1994, a few days prior to the closing of DEC's third fiscal quarter then in progress. Approximately one week later DEC announced an operating loss of over $183 million for the quarter that had just closed, sending stock prices tumbling. 82 F.3d at 1199-1200.

Accepting as true plaintiff's allegation that DEC was in possession of "hard" material information about "unexpectedly large" losses being suffered in the nearly completed quarter, which indicated some "substantial likelihood" that the quarter would turn out to be "disastrous" and "an extreme departure from publicly known trends, and uncertainties," the court held that it could not conclude as a matter of law that such information was not subject to mandatory disclosure. 82 F.3d at 1211.

In so holding, the court rejected DEC's argument that the disclosure requirements of the Securities Act should be interpreted "so that they would *never* mandate the provision of current information about a company's performance in the quarter in progress at the time of a public offering, so long as the company satisfies its quarterly and annual periodic disclosure obligations under the Exchange Act." 82 F.3d at 1209 (emphasis in original).

The court was equally clear that it was explicitly rejecting "any bright-line rule that an issuer engaging in a public offering is obligated to disclose interim operating results for the quarter in progress whenever it perceives the possibility that the quarter's results may disappoint the market." *Id.* at 1210. As the court stressed:

> Far from it. Reasonable investors understand that businesses fluctuate, and that past success is not a guarantee of more of the same. There is always some risk that the quarter in progress at the time of an investment will turn out for the issuer to be worse than anticipated. The market takes this risk of variability into account in evaluating the company's prospects based on the available facts concerning the issuer's past historical performance, its current financial condition, present trends and future uncertainties.

Id.

Having rejected any *per se* rule regarding the disclosure of incomplete quarterly results, the First Circuit was also careful not to imply "that nondisclosure claims similar to those asserted by plaintiffs can never be disposed of as a matter of law." *Id.* at 1210. And, still further undermining Petitioner's contention that there is an intolerable conflict between *Shaw* and *Zucker*, the Court in *Shaw* expressly distinguished *Zucker* on its facts. 82 F.3d at 1211.

Given that the First Circuit Court of Appeals specifically and emphatically refused to adopt a *per se* rule regarding disclosure of interim financial data, and expressly distinguished *Zucker*, the purported "direct conflict" between the circuit courts envisioned by Petitioner and offered here in support of her Petition, simply does not exist.

B. The Decisions In *Zucker v. Quasha* And *Shaw v. Digital Equipment Corp.* Turn On The Unique Facts Of Each Case.

The significant factual differences between *Shaw* and *Zucker* further confirm that the "direct conflict" asserted in support of the Petition is illusory. For example, a critical distinction between the opinion below and *Shaw* is that the stock offering in *Shaw* was conducted pursuant to a "shelf registration" under SEC Rule 415(a). *See* 17 C.F.R. § 230.415(a). As the First Circuit Court of Appeals explained:

> The shelf registration rule permits a company to file a single registration statement covering a certain quantity of securities (register securities "for the shelf"), and then over a period of up to two years, with the appropriate updates of information, issue installments of securities under that registration statement (take the securities "down from the shelf") almost instantly, in amounts and at times the company and its underwriters deem most propitious.

82 F.3d at 1208 (footnotes omitted).

The First Circuit observed that the need for prompt and *continuous* disclosure is "particularly keen" when a corporation issues stock pursuant to a shelf registration statement, because absent such disclosure, an issuer anticipating a negative earnings announcement could time its offering of securities "from the shelf" to be completed prior to the public release of the known negative news, thereby allowing the issuer to exploit a "naked informational trading advantage." *Id.* at 1209.

The decision in *Shaw v. Digital Equipment Corp.* accordingly turned on the requirements of SEC Rule 415, which

the court noted was adopted to combat the potential for abuse inherent in the shelf registration process. Rule 415, the court observed, insures that " '[p]ost-effective amendments [to the initial registration statement] and prospectus supplements [would] serve to ensure that investors are provided with complete, accurate and current information at the time of the offering or sale of securities.' " 82 F.3d at 1208 (quoting Shelf Registration, SEC Release Nos. 33-6499, 34-20384, 35-23122, 1983 WL 35832 (SEC), at *9) (alteration in original).

Given the unique nature of the public offering in *Shaw* and the concerns it raised, the court understandably rejected defendant's position that "there can never be a duty to disclose internally known, pre-end-of quarter financial information." *Id.* at 1210. The court reasoned that defendant's argument would "cut[ ] severely" against the shelf registration rule which permits offerings to be made on a "continuous" basis because it envisions "continuous" disclosure. *Id.* at 1209.

In direct contrast to *Shaw,* the shelf registration rule, and any heightened disclosure obligations that might arise pursuant to it, were simply not before the court below. This important factual distinction further undermines Petitioner's claim of a conflict between the circuits regarding an important issue of law.

Yet another key distinction between *Shaw* and *Zucker* is that, unlike Petitioner here, the *Shaw* plaintiffs asserted that DEC management had in its possession, as of the March 21 offering, "hard data" regarding the company's ongoing quarter-to-date performance. 82 F.3d at 1211. That information indicated that the company would suffer "unexpectedly large losses for that quarter" and that the third fiscal quarter would be "disastrous." *Id.* The First Circuit repeatedly emphasized the central importance of plaintiff's allegation that hard data was on hand reflecting these "actual losses". Indeed, the Court emphasized

that the plaintiff's claim was sustainable *only* to the extent it related to the nondisclosure of hard material information as opposed to soft information in the nature of projections. 82 F.3d at 1211 n. 21.

In direct contrast, the court below held that Petitioner had utterly failed to identify *any* compiled information relating to return rates that existed during the incomplete first quarter of 1994 that was omitted from the Prospectus, and which rendered the statements relating to the return rate in 1993 misleading. 891 F. Supp. at 1016. Noting that the only information that could conceivably have been available would have been in the nature of projections, the court observed that Petitioner "expressly disavowed" reliance on any internal projections and "failed to identify any other source of . . . information that [Hanover] was allegedly obligated to disclose." *Id.*

Moreover, in contrast to the "disasterous" results and the "extreme departure from publicly known trends" at issue in *Shaw,* the information Petitioner herein claims was subject to mandatory disclosure consists of a mere 2% difference in return rates for only a single incomplete fiscal quarter, compared with the return rate for an *entire* fiscal year.

These significant factual distinctions argue strongly against the need for this Court to review the decision below, which clearly turned on a unique factual context.

CONCLUSION

For these reasons, the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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Dated: August 12, 1996

Supreme Court, U.S.
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(3)

No. 95-2080

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

VERONICA ZUCKER, individually and on behalf of a class of others similarly situated,

Petitioner,

vs.

ALAN G. QUASHA; JACK E. ROSENFELD; RALPH DESTINO; J. DAVID HACKMAN, S. LEE KLING, THEODORE H. KRUTT SCHNITT, JEFFREY LAIKIND, ELIZABETH VALK LONG, EDMUND R. MANWELL, GERALDINE STUTZ, ROBERT F. RIGHT, WAYNE P. GARTEN, HANOVER DIRECT INC., SUN LIFE INSURANCE COMPANY OF AMERICA; MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., ALEX BROWN & SONS, INC., individually and on behalf of a class of underwriters similarly situated,

Respondents.

PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

PETITIONER'S REPLY BRIEF

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INTRODUCTION

Certiorari is clearly warranted in this case, and nothing in Respondents' opposition suggests otherwise.

REASONS FOR GRANTING THE WRIT

I. THERE IS A CONFLICT BETWEEN THE CIRCUITS REGARDING THE NECESSITY TO DISCLOSE ADVERSE FINANCIAL RESULTS FROM THE CURRENT, AS YET INCOMPLETE, FISCAL PERIOD

Respondents raise two arguments in opposition to certiorari. Neither justifies denial of the petition.

A. *Zucker v. Quasha*, 891 F. Supp. 1010 (D.N.J. 1995), *aff'd* 82 F.3d 408 (3d Cir. 1996) and *Shaw v. Digital Equipment Corp.*, 82 F.3d 1194 (1st Cir. 1996), State Entirely Inconsistent and Opposing Rules Regarding Prospectus Disclosure of Adverse Financial Results From the Current As Yet Incomplete Fiscal Period.

The District Court held in *Zucker*: "Regardless of whether a public offering occurs seventeen days or only two days before the close of a fiscal quarter, data concerning a quarter that is in progress is necessarily incomplete. As a result, *HDI was incapable of making anything more than projections* regarding return rates for the first quarter of 1994 on March 30, when its Prospectus and Registration Statement became effective." *Zucker* at 1016 (emphasis added).

Since projections need not be disclosed in a Registration Statement, the import of the District Court's holding is clearly that an issuer of securities need never disclose adverse financial information for a fiscal period not complete when the Registration Statement becomes effective.

The First Circuit's ruling disagrees. The First Circuit held that:

> the ability of market observers to evaluate a company depends upon the information publicly available to them. If the issuer is in possession of nonpublic information indicating that the quarter in progress at the time of the public offering will be an extreme departure from the range of results which could be anticipated based on currently available information, it is consistent with the basic statutory policies favoring disclosure to require inclusion of that information in the registration statement.

Shaw at 1210.

B. If the *Zucker* Court Had Applied the Rule in *Shaw*, It Could Not Have Granted Defendants' Rule 12(b)(6) Motion To Dismiss.

In *Shaw*, the prospectus in question was filed 11 days prior to the end of the quarter in progress. The results for that quarter turned out to be the product of more than a minor business fluctuation. The plaintiffs alleged that the defendant, Digital Equipment Corp., by March 21, 1994, was in possession of information about the company's quarter-to-date performance indicating some substantial likelihood that the quarter would turn out to be an extreme departure from publicly known trends and uncertainties. The First Circuit held that it could not conclude as a matter of law and at this early stage of the litigation that such information was not subject to mandatory disclosure under the rubric of "material changes" in Item 11(a) of Form S-3. *Shaw* at 1211.

In HDI, which also conducted its public offering pursuant to a registration statement on SEC Form S-3, the prospectus in question became effective less than three days before the close of the fiscal quarter. *Zucker* at 1012, 1015. The results for that quarter turned out to be the product of more than a minor business fluctuation. The plaintiffs' alleged that

information regarding increased rate of returns must have been available to senior management by the effective date and that HDI was obligated to disclose it. *Id* at 1015. The District Court held that the existence of such an obligation is inconsistent with both *Renz v. Schreiber*, 832 F. Supp. 766, 781 (D.N.J. 1993), and the Ninth Circuit's decision in *In re Worlds of Wonder Securities Litigation*, 35 F.3d 1407, 1418-1419 (9th Cir. 1994). *Zucker* at 1015. The District Court held that as a matter of law, "regardless of whether a public offering occurs seventeen or only two days before the close of the quarter, data concerning a quarter that is in progress is necessarily incomplete." *Id.* at 1016.[1] If the District Court had applied the holding of the First Circuit then the District Court would have found, as the *Shaw* Court found, that it was for the trier of fact to determine whether the registration statement representations on the subject of returns were rendered misleading by the omission of adverse facts known on the effective date.

C. Responses to Respondents' Assertions

Respondents contend that the decision in *Shaw* turned on the requirements of SEC Rule 415(a). (Respondents Br. at 3). However, even a cursory reading of *Shaw* would indicate that the First Circuit based its ruling on the obligations that attend the preparation of a registration statement and prospectus. *See Shaw*, 82 F. 3d at 1202-1211. *See Glassman v. Computervision*, 1996 U.S. App. LEXIS 18765, *17 (1st Cir. July 31, 1996). The First Circuit held only that the need for prompt and continuous disclosure is "particularly keen" when a corporation issues stock pursuant to a shelf registration statement. *Shaw* at 1208.

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[1] This quote highlights petitioner's contention (Petition at 7, fn. 1) that the First Circuit mischaracterized the holding in *Zucker* as dismissing the complaint based on alleged nondisclosure in a March 31 registration statement of information relating to results of period ending July 2. *See Shaw*, 82 F.3d at 1211 and *See* Respondents' Brief at 7.

Respondents contend that Petitioner has failed to identify any compiled information relating to return rates that existed during the first quarter of 1994. (Respondents Br. at 10). However, in *Shaw*, the First Circuit accepted on a motion to dismiss the complaint's allegations that the defendant had in its possession as of the offering date nonpublic information concerning the company's ongoing quarter-to-date performance. *Shaw* at 1207. Similarly, the District Court should have accepted on defendants' motion to dismiss petitioner's allegations that HDI had information regarding increased rate of returns and that HDI was obligated to disclose this information. *Zucker* at 1015.

Respondents contrast the "disastrous" results and the "extreme departure from publicly known trends" at issue in *Shaw* with the information which Petitioner claims was subject to mandatory disclosure. (Respondents Br. at 10). However, in *Zucker* Petitioner claims that HDI experienced a *15%* increase in returns compared to the first quarter in 1993 (an increase from 13% of gross shipments in the first quarter of 1993 to 15% of gross shipments in 1994). *Zucker* at 1015. In HDI's 10-Q for the quarter ending on April 2, 1994, the issuer itself stated that "Revenues were negatively impacted by an increase in customer returns to approximately 15% of shipped sales in the first quarter of 1994 from approximately 13% for the same period in 1993." And it is clear from both the first quarter and second quarter Form 10-Q reports that unquestionably material declines in the issuer's profitability were caused in part by the increased returns.

CONCLUSION

The petition for writ of certiorari should be granted.

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Respectfully submitted,

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